

CITY OF SAN DIEGO  
M E M O R A N D U M

DATE: June 9, 2004

TO: Honorable Mayor and City Council

FROM: P. Lamont Ewell, City Manager

SUBJECT: Fiscal Year 2005 Proposed State Impact Solutions

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On May 13, 2004, Governor Schwarzenegger announced his Revised State Budget Proposal, known as the May Revise. The financial impact to local governments, as outlined in the May Revise, reflects a substantial change from what was outlined in the Governor's original State Budget Proposal on January 9, 2004. The total impact to the City of San Diego as a result of the Governor's Revised Proposal and other proposed legislative action is estimated to be \$17.3 million in lost revenue for Fiscal Year 2005.

The Governor's original State Budget Proposal relied in part on a \$1.3 billion "contribution" from local governments to the State in the form of additional property tax shifts to the Educational Revenue Augmentation Fund (ERAF). This contribution resulted in an estimated \$9.5 million loss for the City of San Diego. In addition, State reimbursements for booking fee expenses were to be eliminated, resulting in an additional loss for the City of approximately \$5.2 million, or a total loss of \$14.7 million.

In the May Revise, the Governor maintained the \$1.3 billion contribution from local governments, but changed the share for each jurisdiction. In the original budget proposal, counties were required to contribute the largest portion of the \$1.3 billion, while contributions from cities represented a much smaller share. In the May Revise, the burden has been spread more evenly across all jurisdictions. The table below compares the January and May Revise allocation proposals.

	<b>January Budget Proposal</b>	<b>May Revise Proposal</b>
<b>Cities</b>	\$183 million	\$350 million
<b>Counties</b>	\$887 million	\$350 million
<b>Redevelopment</b>	\$135 million	\$250 million
<b>Special Districts</b>	\$105 million	\$350 million
<b>TOTAL</b>	<b>\$1.3 Billion</b>	<b>\$1.3 Billion</b>

The substantial increase in the expected contribution from cities resulted in the impact to the City of San Diego in Fiscal Year 2005 increasing from the \$9.5 million loss to a \$17.3 million loss. The May Revise also maintained the elimination of booking fee reimbursements, resulting in a total estimated loss to the City of \$22.5 million.

In working with the City of San Diego's State representatives, there appears to be support for having the State restore booking fee reimbursements for the next two years. Our State representatives are pursuing the restoration of booking fees during the State's Budget Conference Committee, so that the City may avoid further reductions in critical service areas.

For the past three years the State has proposed eliminating the booking fee reimbursements and each year they have been restored primarily through the leadership of our State delegation. We are hopeful that our State delegation will be successful in demonstrating the disproportionate impact to the City by including these booking fees in the proposed reductions, and in assisting the City with its efforts to retain this revenue over the next two years. If they are successful in maintaining the booking fee revenue, the total anticipated State reduction in Fiscal Year 2005 is estimated to be \$17.3 million.

In addition to these changes, the Governor's May Revise also proposes that an amendment to the State Constitution be placed before the voters in the November election that would dramatically change the landscape of local government finance. This constitutional amendment was largely developed through negotiation with the League of California Cities, the California State Association of Counties, the California Redevelopment Association, and the California Special Districts' Association. The main features of the proposed amendment are listed below:

1. **Constitutional protection of local revenues.** The State would not be able to reduce the tax rates or reallocate or delay any local government's share of sales tax, property tax or vehicle license fees (VLF), except as provided for in item No. 2;
2. **State Fiscal Relief.** The State would take \$1.3 billion in local government revenue in Fiscal Years 2005 and 2006 to help balance the State budget. Any further revenue shifts from local governments to the State are prohibited, unless approved by statewide voters.
3. **VLF Backfill for Property Tax Swap.** The current VLF rate of 0.65 percent would be written into the constitution as the maximum rate. The VLF backfill would be eliminated, and instead local governments would be reimbursed through a property tax shift from ERAF.
4. **Local Mandates.** The State would be required to reimburse local government for all State-imposed mandates. If local governments are not reimbursed, then the mandate would automatically sunset, unless pertaining to education programs or employee rights or benefits. In addition, the State will agree to repay in Fiscal Year 2007 the \$1.3 billion that local governments lost in Fiscal Year 2004 as a result of the VLF Gap period.

The following table provides a look at the proposed State impacts to the City of San Diego's major revenue categories over a five-year period, beginning in Fiscal Year 2004.

	FY 2004	FY 2005	FY 2006	FY 2007	FY 2008
<b>Booking Fees</b>	-	-	-	(\$5.2 million)	(\$5.2 million)
<b>Triple-Flip*</b>	-	(\$2.5 million)	-	-	-
<b>VLF Backfill "Gap"</b>	(\$16.7 million)	-	-	\$22.8 million	-
<b>City Contribution**</b>	-	(\$17.3 million)	(\$17.3 million)	-	-
<b>TOTAL</b>	<b>(\$16.7 million)</b>	<b>(\$19.8 million)</b>	<b>(\$17.3 million)</b>	<b>\$17.6 million</b>	<b>(\$5.2 million)</b>

\* Under the Triple-Flip, 1/4 cent of the City's sales tax will be swapped for an equivalent amount of property tax. The loss in FY05 results from the growth on the swapped revenue not being paid until January of FY06.

\*\* Part of the negotiated 2-year, \$700 million "contribution" from cities.

## **PROPOSED STATE SOLUTIONS**

As the preceding table reflects, State impacts will cost the City of San Diego an estimated \$19.8 million in Fiscal Year 2005. However, the \$2.5 million loss due to the Triple-Flip has already been accounted for in the City's Fiscal Year 2005 Proposed Budget, resulting in a net impact of \$17.3 million. The Triple-Flip is the 1/4-cent sales tax reduction that will be swapped for an equivalent amount of property tax. The loss in Fiscal Year 2005 is because the growth on the swapped revenue will not be paid until Fiscal Year 2006. To address the \$17.3 million shortfall in Fiscal Year 2005, a list of solutions is presented below.

These proposed State solutions include one-time revenues totaling \$5.0 million. Should the State impact in Fiscal Year 2005 amount to less than the estimated \$17.3 million, it is important to remember that we face a two-year problem. I therefore recommend that any surplus realized from these State solutions be held in reserve for anticipated State impacts in Fiscal Year 2006, which will again impact the General Fund with a loss estimated at \$17-\$22 million. Other equally prudent options appropriate in providing long term solutions to the City finances would include increasing the contributions to the Unappropriated Reserve or the Retirement System.

As previously stated, the Governor's Proposed State Budget would eliminate booking fee reimbursements. However, in anticipation of our legislative representatives' success in restoring these reimbursements, we are not proposing any reductions related to the loss of booking fee revenues at this time. Should the City not receive the \$5.2 million in booking fee reimbursements, the City Manager would return to the City Council with additional solutions to achieve a balanced budget.

<u>Proposed State Solutions</u>	<u>Savings</u>
Major Revenue Growth	\$6,450,000
Additional Program Adjustments	\$1,000,000
State Contingency Reserve Fund	\$3,900,000
Business Tax Processing Fee	\$3,100,000
SDDPC General Fund Savings	\$2,000,000
Parking Meter Increase Waiver	\$550,000
Mission Bay Ordinance Waiver	\$500,000
<b>TOTAL POTENTIAL SOLUTIONS</b>	<b>\$17,500,000</b>

The following provides a brief explanation of the proposed State solutions.

#### **Major Revenue Growth**

Since the Fiscal Year 2005 Proposed Budget was presented on May 3, 2004, staff has been analyzing economic conditions and has revised the projections for several major general fund revenues. A revised growth forecast in sales tax revenue is estimated to result in an additional \$1.8 million, while VLF revenue is estimated to contribute an additional \$3.0 million due to upward trending in current-year receipts.

#### **Additional Program Adjustments**

Program expenditure reductions of \$745,000 and additional program revenue of \$255,000 have been identified to contribute a net of \$1.0 million to the State solutions. This is in addition to the \$26.9 million in programmatic reductions included in the Fiscal Year 2005 Proposed Budget. These adjustments include: the net elimination of 3.40 FTE positions in the Equal Opportunity Contracting, Financial Management, General Services, and Personnel Departments; reductions in the Citywide Department budget which may impact office lease budgets, and data processing development; and additional revenue in the Auditor's Office and the City Treasurer's Department. Reductions were not identified in the public safety departments, the Park and Recreation Department or the Library Department.

#### **State Contingency Reserve Fund**

In Fiscal Year 2003, the City Auditor identified savings in the General Fund in anticipation of potential State revenue impacts in Fiscal Year 2004. As a result of expenditure savings and general revenue growth, the State Contingency Reserve Fund was not required as a solution for Fiscal Year 2004. It was instead held for possible State revenue impacts for Fiscal Year 2005.

**Business Tax Processing Fee**

The City of San Diego processed over 138,000 business tax and rental unit tax applications in Fiscal Year 2004, at an estimated cost of \$3.5 million. Implementing an annual processing fee of \$25 for applications and renewals can be implemented by Council action. Such a fee would generate approximately \$3.5 million, offsetting the cost of processing business and rental unit tax applications. Assuming implementation beginning August 1, 2004, this fee would generate approximately \$3.1 million in Fiscal Year 2005.

**SDDPC General Fund Savings**

An additional \$4.0 million in cost reductions are to be achieved by the San Diego Data Processing Corporation (SDDPC). These will be achieved primarily through staff attrition, consolidation of facilities, reduced discretionary spending and delay of capital spending, thus reducing depreciation expense. Approximately \$2 million of the savings will benefit the General Fund and \$2 million will provide savings to non-general funds.

These proposed actions will be subject to SDDPC Board approval and will include a review by both City staff and SDDPC staff of service level agreements.

**Parking Meter Increase Waiver**

Council Policy 100-18 establishes Parking Meter Districts and commits to each District a certain portion of the parking meter revenues that are collected within the District. Currently, 45% of total budgeted parking meter revenues are allocated to the Parking Meter Districts. Council Policy 100-18 also establishes the means by which revenues are allocated between Parking Meter Districts, and what such revenues are to be used for.

In Fiscal Year 2004, parking meter fees were increased and Council Policy 100-18 was waived with respect to the allocation of the increased fees to Parking Meter Districts. It is again proposed that the policy be waived for Fiscal Year 2005 with respect to the revenue related to the fee increase adopted in Fiscal Year 2004. This would provide an additional \$550,000 of available funding to the General Fund.

**Mission Bay Ordinance Waiver**

Pursuant to the Mission Bay Ordinance, one-half of all Mission Bay lease revenues in excess of \$20 million are to be directed to the Regional Park Fund and the Mission Bay Improvement Fund. The Fiscal Year 2005 Proposed Budget included an estimated allocation of \$1.5 million for the Regional Park Fund and Mission Bay Improvement Fund. A May 17, 2004, memorandum from Councilmembers Frye, Zucchet and Deputy Mayor Atkins (approved by the Mayor and City Council on May 18<sup>th</sup>) requested that the Fiscal Year 2005 proposed funds allocated to the Regional Park Fund and the Mission Bay Improvement Fund be combined with existing fund balances (\$300,000). \$1.3 million is to be allocated to the Park and Recreation Department for the restoration of critical services, and the remaining \$500,000 to the General Fund in anticipation of Fiscal Year 2005 State impacts.

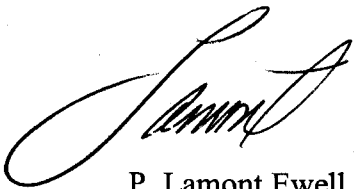
June 9, 2004

**SUMMARY**

The Governor's May Revise presents a new challenge for the City of San Diego in Fiscal Year 2005 and beyond. The May Revise and other legislative proposals estimates the revenue loss to the City at \$17.3 million in Fiscal Year 2005, an increase of \$2.6 million from the Governor's original Budget Proposal. In addition, the proposed amendment to the State Constitution in the May Revise would bring dramatic changes to the City's revenue base, while at the same time securing constitutional protection of local revenues.

To address the anticipated \$17.3 million revenue loss in Fiscal Year 2005, the City has proposed a broad range of State solutions, comprised of both ongoing and one-time measures, totaling \$17.5 million. While the sum of these solutions is sufficient to cover the estimated State impact in Fiscal Year 2005, it should be reiterated that if the City does not receive the \$5.2 million in booking fee reimbursements, the City Manager would have to return to the City Council with additional solutions to achieve a balanced budget.

Aside from the challenges in Fiscal Year 2005 brought about by State impacts, the City is still facing increased pension obligations in the coming years, a need to increase its general reserves, correct the structural imbalance, and restore its credit rating. It is recommended that these issues be given priority consideration should any surplus from the proposed State solutions be realized in Fiscal Year 2005. These proposed State solutions will be presented to the Mayor and City Council on June 14 for deliberation with the budget agenda of June 21, 2004.



P. Lamont Ewell  
City Manager

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